

Participants *Already* Have Choice

The Impact of HB 4338

Four Issues of Concern

If enacted, HB 4338 would require the Department of Technology, Management and Budget (DTMB) to contract with three to eight defined contribution plan providers for employees that are qualified participants of the State of Michigan 401(k) and 457 Plans.

HB 4338 presents four issues of concern:

1. Choice – participants can already choose whom to work with for advice on their account
2. Cost to participants
3. Cost to the State of Michigan
4. Fiduciary issues/lawsuits

Participants Already Have Choices

Participants in the State of Michigan 401(k) and 457 Plans already have choices for plan advice including:

- Free online advice, or a low-cost professional account manager provided through the plan
- The ability to work with a local Registered Investment Advisor (RIA) who can receive compensation through the plan
- The ability to work with a local Broker-Dealer Agent, who can be compensated outside the plan

Different Fiduciary Standards

- Why does the plan distinguish between RIAs and Broker-Dealers?
 - RIAs must act *exclusively in the best interest of their client*.
 - This is a high fiduciary standard. RIAs provide a service to their clients and are compensated through a flat fee or flat percentage, incenting the advisor to maximize the client's *overall* account balance.
 - Broker-dealers are only required to direct their clients towards investments that are generally “*suitable*.”
 - This is a lower fiduciary standard than what the plan currently requires. Broker-dealers sell investment products - which typically means higher costs, as broker-dealers direct participants to investment options that yield higher commissions.

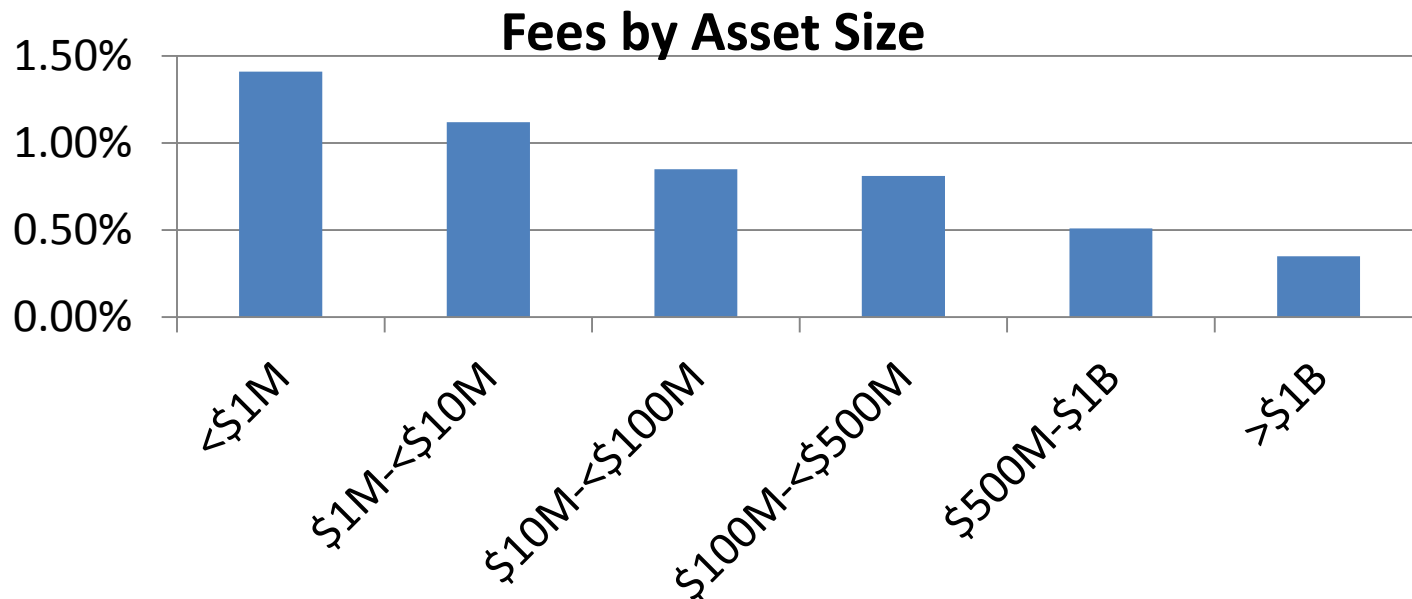
Cost to Participants

- The State of Michigan's retirement plan is large, with around 170,000 participants and over \$7 billion in assets, giving ORS an edge to negotiate the most competitive fee structures available. Currently, participants in the state's plan pay an average of between .297% and .392% in total fees, depending on which plan features they access.
- Public school employee balances represent only about \$280M of the total assets of over \$7 billion; today, they benefit from the economics of scale associated with size of the overall plan.
- Participants in smaller, decentralized plans pay fees as much as four times higher in order to cover the fixed costs.¹

¹ Deloitte Investment Company Institute

Participants Assume the Burden of Higher Fees

Plans with larger assets are able to provide lower fees to participants.



Source: Deloitte Investment Company Institute

Higher Fees Mean Smaller Nest Eggs for Retirees

- Over the course of a career, participants in smaller (higher-fee) plans end up with less in their retirement savings than those in a low-cost plan because of the effect of fees.
- Even a small difference in fees can have a large impact. An Aon Hewitt study shows how the ultimate balance of a \$100,000 account returning 5% annually can be dramatically different depending on the fees charged.

Source: *How 403(b) Plans are Wasting Nearly \$10 Billion Annually, and What Can Be Done to Fix It*, Aon Hewitt, January 2016

The Impact of Fees

Total Costs	Account Balance				
	5 Years	10 Years	20 Years	30 Years	40 Years
0.00%	\$127,628	\$162,899	\$265,330	\$432,194	\$703,999
0.50%	\$124,618	\$155,297	\$241,171	\$374,532	\$581,636
0.75%	\$123,135	\$151,621	\$229,891	\$348,564	\$528,497
1.00%	\$121,665	\$148,024	\$219,112	\$324,340	\$480,102
1.50%	\$118,769	\$141,060	\$198,979	\$280,679	\$395,926

Current State

HB 4338

Source: *How 403(b) Plans are Wasting Nearly \$10 Billion Annually, and What Can Be Done to Fix It*, Aon Hewitt, January 2016

Cost to the State of Michigan

- HB 4338 would dramatically increase administrative costs for the Office of Retirement Services (ORS) due to:
 - Contract compliance and monitoring
 - Investment review and monitoring
 - Participant inquiries and escalations
 - Service level and performance reviews
 - Monthly, quarterly and annual reporting
 - Communication materials development and review
 - Additional audit and legal costs
- ORS Administrative costs under the current system:
\$2.1 M
- ORS Administrative costs under HB 4338:
\$6.3 - 18.2 M

Increased Exposure to Potential Lawsuits

- Adding additional providers greatly increases the fiduciary liability for the state.
 - Spreading plan assets over many investments weakens the plan's leverage to bargain for lower fees.
 - HB 4338 attempts to legislate away the state's fiduciary liability, but this cannot be done under the federal framework.
- The very structure that HB 4338 proposes has resulted in an increasing number of lawsuits for breach of fiduciary duty and excessive fees.
 - Nearly a dozen universities are facing litigation over their 403(b) plans accused of fiduciary duty breaches, including Yale University².
 - The lawsuit against Yale alleges that 403(b) plan participants paid excessive record-keeping fees as a result of using multiple record keepers, rather than going out to bid for a sole provider.
 - The suit alleges that the university caused plan participants to pay duplicative, excessive and unreasonable fees.

² <http://www.pionline.com/article/20160809/ONLINE/160809871/mit-yale-and-nyu-sued-over-charging-excessive-dc-plan-fees>

Other State Trends

- This is counter to the direction that the industry in general is headed.
 - For example, Arnerich Massena recently conducted a study for the State of Colorado that indicated that a single recordkeeper system was far better for the state and for participant outcomes as compared to a multiple-provider system.

Conclusion

- HB 4338 will negatively impact the future financial security of public school employees in the state's 401(k) and 457 plans.